

Message Text

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ACTION EB-04

INFO OCT-01 SS-04 ISO-00 EUR-03 TRSE-00 CEA-01 NSC-04

NSCE-00 INR-01 FRB-03 CIAE-00 /021 W

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R 271822Z JUL 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 4016

TREASURY DEPT WASHDC

INFO AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY BONN

AMEMBASSY TOKYO

USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 11708

LIMDIS GREENBACK

DEPARTMENT PASS FRB

TREASURY FOR DONALD SYVRUD, OASIA

E.O. 11652: XGDS-1

TAGS: EFIN, UK

SUBJECT: BANK OF ENGLAND ON THE CHANCELLOR'S MONETARY
TARGET, OUTLOOK FOR BORROWING, AND STERLING

1. FINANCIAL ATTACHE ASKED TWO SENIOR BANK OF ENGLAND
(BOE) ADVISERS FOR FURTHER DETAILS ON THE MONETARY GROWTH
TARGET GIVEN BY THE CHANCELLOR IN HIS PUBLIC EXPENDITURE
PACKAGE ANNOUNCEMENT JULY 22. THE CHANCELLOR SAID, QUOTE
BECAUSE BORROWING NEEDS AND GILT SALES INEVITABLY VARY
FROM QUARTER TO QUARTER, WE MUST EXPECT RATES HIGHER THAN
THIS FOR SOME PERIODS, ESPECIALLY TOWARDS THE END OF THE
FINANCIAL YEAR.

QUOTE IT IS A MISTAKE TO ATTACH TOO MUCH SIGNIFICANCE TO
SUCH FLUCTUATIONS. FOR THE FINANCIAL YEAR AS A WHOLE
MONEY SUPPLY GROWTH SHOULD AMOUNT TO ABOUT 12 PERCENT.

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UNQUOTE

2. FINANCIAL ATTACHE ASSUMED CHANCELLOR WAS DISCUSSING M3; WAS THIS CORRECT? SOURCES REPLIED IT WAS LOGICAL TO ASSUME M3, BUT NOT NECESSARILY CORRECT. THE 12 PERCENT MONEY SUPPLY GROWTH FIGURE COULD RELATE TO M1, OR M3, OR DOMESTIC CREDIT EXPANSION; I.E., BORROWING REQUIREMENT, PURCHASES OF PUBLIC SECTOR DEBT BY THE PRIVATE SECTOR (OTHER THAN BANKS), LENDING TO THE PRIVATE SECTOR, PLUS BANK LENDING IN STERLING TO OVERSEAS RESIDENTS, LESS BANK LENDING IN FOREIGN CURRENCIES TO UK RESIDENTS FOR INVESTMENT OVERSEAS. IN OTHER WORDS, THE TARGET IS DELIBERATELY VAGUE AND AT THE END OF THE FINANCIAL YEAR IT WILL PROBABLY APPLY TO WHICHEVER OF THE MEASURES IS CLOSEST TO 12 PERCENT.

3. ONE SOURCE SAID HE WAS DISAPPOINTED THAT A MORE PRECISE TARGET HAD NOT BEEN INCLUDED IN THE MESSAGE. IT COULD HAVE BEEN DONE WITH VERY LITTLE COST OR DIFFICULTY AND WOULD HAVE HAD A FAVORABLE IMPACT ON THE FOREIGN EXCHANGE MARKETS. INFIGHTING AT THE BANK OF ENGLAND AND TREASURY FOUND OFFICIALS IN EACH INSTITUTION BOTH IN FAVOR AND AGAINST INCLUSION OF A FIRMER TARGET. GOVERNOR OF THE BOE, HINTING IN PUBLIC THAT SUCH A TARGET WAS UNDER CONSIDERATION, CITED POSITIVE FACTORS AND NEGATIVE FACTORS, THEN DECIDED TO DO NOTHING.

4. FINANCIAL ATTACHE QUERIED BOE OFFICIALS ABOUT PRESS REPORTS HERE (SEE PARA 9 OF LONDON 11607) THAT NO MORE CUTS COULD BE MADE AND THAT IF THERE WERE IMF PRESSURE IN THIS DIRECTION, RESORT MIGHT HAVE TO BE MADE TO IMPORT CONTROLS. BOE OFFICIALS DOUBTED THAT TREASURY OFFICIALS HERE WOULD HAVE TAKEN SUCH A POSITION (UNFORTUNATELY SEN-

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LIMDIS GREENBACK

IOR HMT OFFICIALS WHO MIGHT COMMENT ON THIS ARE CURRENTLY ABSENT FROM LONDON.) THEY REMARKED HM TREASURY KNOWS FULL WELL THERE IS EVERY LIKELIHOOD THEY WILL HAVE TO BORROW FROM IMF. SOURCES SPECULATED THAT OPPONENTS OF FURTHER CUTS MIGHT HAVE LEAKED OR PLANTED THE STORIES. THIS SAID. A REPORT IN LONDON TIMES FRIDAY JULY 23. BY FRANK VOGL. HEADLINED "IMF MAY SEEK MORE CUTS IF ANOTHER LOAN IS SOUGHT" INDICATING IMF MIGHT INSIST ON MUCH MORE SUBSTANTIAL PUBLIC EXPENDITURE CUTS THAN THOSE ANNOUNCED LAST WEEK, HAS NOT GONE DOWN WELL WITH OFFICIALS HERE. BOE OFFICIALS DO NOT RULE OUT FURTHER IMF PRESSURE AND POSSIBLE NEED FOR ADDITIONAL CUTS OR MEASURES AT THE TIME OF NEXT YEAR'S MARCH-APRIL BUDGET ANNOUNCEMENT. OBVIOUSLY MUCH WATER WILL FLOW UNDER THE BRIDGE BEFORE THEN.

5. DURING DISCUSSIONS ON GENERAL SUBJECT OF PUBLIC EXPENDITURE CUTS, REVENUE INCREASES AND REDUCTION ON PSBR, BOTH HMT SENIOR CAREER STAFF AND BOE OFFICIALS IN PRIVATE COMMENTS INDICATE THEY HAVE NO PARTICULAR FAITH THAT THE

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CONSERVATIVE PARTY WOULD BE ABLE TO DO ANY BETTER JOB THAN CHANCELLOR HEALEY IS CURRENTLY DOING; SOME OF THEM INDICATE THEY BELIEVE THE CONSERVATIVES WOULD DO LESS WELL. A KEY ELEMENT THEY SEE IN FUTURE DEVELOPMENTS IS TRADE UNION REACTION TO CUTS IN REAL DISPOSABLE INCOME AND NEGOTIATION OF NEXT ROUND OF PAY POLICY IN FIRST HALF NEXT YEAR. THEY CANNOT RULE OUT POSSIBILITY OF A WAGE EXPLOSION. ESPECIALLY IF ECONOMY AND PROFITS ARE ON THE UPTURN AND UNEMPLOYMENT IS FALLING. IN OTHER WORDS, IN THEIR VIEW IT IS POSSIBLE THAT THE REAL CHALLENGE HAS NOT YET COME. THIS POINT HAS NOT BEEN LOST ON BANKERS AND FOREIGN EXCHANGE MARKET OPERATORS, NONE OF WHOM EXPRESS ANY CONFIDENCE THAT STERLING WILL RISE ABOVE \$1.80, AND MOST OF WHOM EXPECT A GRADUAL DECLINE (SEE

ALSO PARA 7, LONDON 11383).

ARMSTRONG

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